

Episode release date: 6 September 2022

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- **Catherine Mann**, External member of the Monetary Policy Committee at the Bank of England (CM)
- **Adrian Pabst**, Deputy Director at the National Institute of Economic and Social Research (AP)

Should the next prime minister embrace productivity as a cornerstone of the policy agenda for the next government in the UK starting in September? Can productivity help in getting us through the economic winter ahead and onto a path of sustained recovery? Which policies are the most critical? Which should be continued, strengthened, or perhaps stopped? We are going to find out. Welcome to Productivity Puzzles.

Hello and welcome to the 20th episode of Productivity Puzzles, your podcast series on productivity brought to you by the Productivity Institute and sponsored by Capita. I'm Bart van Ark, I'm a Professor of Productivity Studies at the University of Manchester and the Director of the Productivity Institute, a UK-wide research body on all things productivity in the UK and beyond.

Welcome to this final episode of Productivity Puzzles season number one. We still owe you a 20th episode to close out our first year of the podcast series, and if you missed any of the previous episodes, you can access them on our website at [productivity.ac.uk](http://productivity.ac.uk), or through your favourite podcast channel. Now in light of recent political developments, we decided to leave our announced episode on regional productivity and equalities for the next season of Productivity Puzzles, which will start soon, and instead we want to focus this last episode on the policy agenda for the new government in the UK, of course with a focus of productivity.

During the context for the prime ministership over the past six weeks, the talk was definitely more about taxes and inflation than about productivity. Except for some interesting references to workers not working as hard as elsewhere, including the so-called 'need more graft' remark. But as you know, at the Productivity Institute, we have entertained quite a few different explanations for the productivity shortfall of the UK. So we thought it would be useful for this podcast to discuss the key elements of a policy agenda for productivity that should really help productivity to recover. There is nothing like a productivity policy, there's nothing like a silver bullet to solve the productivity problem in one shot. But there are many policy areas that

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often come together at either Number 10 or Number 11 which are key to raise productivity.

So I have the pleasure today of discussing these issues with three great panellists who are very experienced in the area of productivity and policies. First of all, I'm happy to welcome Catherine Mann to this podcast. Catherine is an external member of the Monetary Policy Committee at the Bank of England since 2021. She's also an expert on productivity issues globally, which she worked extensively on in her former role as chief economist at Citibank. And especially also at the OECD as well as at the Brandeis University and at Peterson Institute for International Economics in Washington. Catherine, it's great to have you on and thank you for joining us in this last episode in season one.

CM: I'm very pleased to be with you.

BVA: Important topics to discuss, so we're glad to have you here.

Second, I am joined by my colleague Diane Coyle, Professor of Public Policy of the Bennett Institute for Public Policy at Cambridge University. She's joining us once again today. Diane leads the TPI in knowledge capital theme and holds the record of returning to this podcast for the fifth time this year. It's always great to hear from Diane on many issues, but especially good reason today, is that she recently wrote an Op-Ed in the FT titled Tax Cut Vows are a Distraction from the UK's Woeful Productivity, which we have provided a link to in the show notes. So it's great to have you again here, Diane.

DC: As you know, Bart, I can't stay off this podcast.

BVA: Okay, well, we'll take note of that.

Our third panellist, Adrian Pabst, is a Deputy Director at the National Institute of Economic and Social Research, which is one of our partners in the Productivity Institute. A political economist, Adrian co-leads our research female institutions and governance. He has written extensively on the interaction between political economy, contemporary politics and fiscal policy. And his taking part in this podcast underlines once again that productivity issues are not just about economics but need a broader perspective, including political science and other academic fields, as we do at the Productivity Institute. Adrian, thank you for joining us today.

AP: I'm really delighted to be here, Bart, thank you.

BVA: Good. Now I thought we should perhaps start off our discussion by focusing perhaps a little bit on the economy as a sort of pyramid with some good productivity performance at the top. And the broad range of weaker performance at the bottom of the pyramid. And we can apply that metaphor

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to firms, we can apply to industries, we can even apply to places. And we need policies for both parts of that pyramid. The top needs policies that helps them to remain leading, or even kept stronger, and not just nationally but also globally. And the bottom needs policy so that they can strengthen their performance, grow faster, and better create more value and create more jobs.

So I want to start with the top of the pyramid in this discussion and I think our diagnosis, and a lot of that has been confirmed in our own TPR research at the Productivity Institute, is that one reason for the UK's shortfall in productivity relative to other countries is that we have a relatively small top, a relatively narrow top, in terms of really good performers. There are multiple reasons for that, which were so discussed in earlier podcasts, but let's zoom in a little on where policy opportunities are possible to strengthen the performance of the top.

And Diane, I'd like to start with you because you've been doing quite a bit of work around industry and also firm performance. And I've also come to the conclusion, I think, that there is a problem in the UK with greater weakness at the top. So can you take us a little bit through what's happening there, but also what that then means for the policy agenda going forward?

DC: Sure. So what we're starting to see in the research is that the best firms in terms of productivity performance are pulling further ahead. And as you say, Bart, in your introduction there, we don't have as many of those as we might like. That seems linked to a number of issues, partly perhaps market concentration, but also partly about the way these firms are using new technologies and the bigger ones seem to be more adept at having the skills they need inhouse and adjusting their processes in a way that will help them increase their productivity.

But some other really interesting work that I've done recently with a colleague of mine is looking at which sectors of the economy do best. And in the UK, we think of things like AI or the auto sector or finance as our leading sectors, and there are indeed very high value ones. But if you look at the slowdown in productivity since the mid-2000s, they're the ones where the slowdown has been the most pronounced. Their slowdown is contributing most to the slowdown that we see in the national figures.

So there's something odd going on that I don't think I understand well yet, about why it is that our best performers in the economy seem to be doing so relatively badly compared to other countries at the moment. So I'm just kind of expanding your puzzle, expanding on your question a bit, rather than saying I've got the answers to it. But there's definitely an issue that we need to dig into there.

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**BVA:** So, Catherine, let's bring you in because I mentioned this earlier at the OECD, you actually did a lot of work, particularly on top performing firms, showing that there was this widening gap with firms, other firms that were falling behind. So this is not just a sector issue, it's also a firm issue, that in each industry, there's actually top performing firms that are going ahead of the rest. So what does that mean and what are the implications of that for policymaking?

**CM:** Right, so we do talk about top performing firms and then sort of the long laggards, and we're going to talk about the laggards later. But when we talk a little bit about what are the characteristics of top performers, and then why do they matter to all of these other companies, informs people and regions around the country? So I think the way to describe this is top performers are part of global corporate families. They are more intensive in digital and in tangible capital and they spend more on innovation and training. So that's what makes them top performers. They're global, they're digital, and they do a lot for their own workers.

So if we keep with the family metaphor, the top performers, why they matter and why we care about their performance for our other companies in the country, is that top performers link internally to domestic firms and they link externally to global markets, both as exporters and importers. So for domestic firms that are part of this corporate family, they become globally engaged even if they don't directly export or import. So smaller firms, that again are not directly engaged in the global economy, they can access the global markets, like technology, to increase their opportunities and approaches to generating value added. In other words, to enhance their own productivity growth.

So these global relationships, even when indirect, provide competitive discipline, and they raise the bar on productivity for everyone else. So it really does matter what is happening at the top for everyone else in the economy.

**BVA:** So one of the policies is that the previous government has been very focused, and I'm sure the next government will as well, is we need more research and development to make sure that these top performers have enough firepower to create new technologies and drive innovation, create these intangibles that you talked about, Catherine. So there is policy in place, but there is somehow the observation that apparently the top is not getting any bigger because of it, and perhaps even, we don't quite know, but perhaps even the top performers aren't really benefitting from it very much either.

So as much as we like R&D policy, it hasn't been paying off so far. Do we have any indication that perhaps it's not as strong in terms of its effects that it has than we would have been hoping for?

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DC: It's an interesting question and the standard answer is that we are great at R&D and we're not so good at actually the development part and the translation and research and turning that into companies that grow. There are some clear research strengths in the UK and there are lots of start-ups around them, but very few big companies. And so I wouldn't say the conclusion to draw from the observation you just made is that we stop funding research and development and we care about it less, but that we need to worry about what is it in terms of financial structures or access to markets or access to skills that makes it harder for companies to grow?

So if you take an example like AI or materials, we've got lots of great universities, great start-ups in these areas, but just not so many globally recognised large companies. I would put money on the finance question mattering a lot, that for many start-ups, the exit strategy they see is to get bought by a big overseas company because that's so much easier than trying to list on the UK stock exchange and grow that way. And then even when we get companies that do float on the public markets, they then tend to get bought by large international companies as well. And over time, the research and development base in the UK gets eroded and run by the foreign owners.

So I would cherish our research strength, it's internationally, where we do absolutely punch above our weight, but very much more about how do we solve that actually very long standing problem with growing companies?

BVA: Yeah. And to be clear, I absolutely wouldn't want to suggest that we shouldn't have R&D policies, but I wonder, Catherine, are there other countries where we can learn in terms of making our R&D policies more effective? Is it just a matter of how much you put in, or are there other things that we can do better, in terms of making our R&D policies work?

CM: Well, one of the things that is an important feature of successful R&D policy is the effective business academic and worker collaboration. I mean, it is all three parties, including finance, that increases the effectiveness of R&D spending. And again, we have to recognise that it is a global marketplace that is going to be the wherewithal or growing the company. It's not going to grow internally, it grows because it becomes part of the global marketplace. So there are other countries that recognise this global opportunity set more effectively and looks to that immediately as being the place to put the effort. And then combine, as I say, business, academic and worker collaboration.

BVA: Adrian, I want to bring you in because I mentioned, when I introduced this section, also the role of place. In the UK, we know that we have a rather narrow top of the pyramid when it comes to the places that are very productive, obviously London, the South East, parts of East Anglia. There are some other parts in the country that are relatively small areas where we

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have a strong performance in terms of productivity. We're going to talk about the weak performance a little later.

So let's focus for the moment on the strong performance. The reason why we have these strong performers is what the economists call agglomeration effects. And the question of course is at the moment are the agglomeration effects, how will we make sure that these strong regions remain very strong? That we really leverage those agglomeration effects further in order to keep those places that are doing well continuing to do well, so that they compete not just nationally but also globally, or at least at the European level?

AP: I think the answer to that very good question is that policies have to be place and, indeed, people-specific. There isn't really a sort of one size fits all model. You wouldn't want a country of sort of, you know, London and lots of little Londons scattered around the place, because that's not going to be a model of success for the whole country. London, and as you say, Bart, the metropolitan parts of the South East, Cambridge, Oxford, and other such areas, have been very successful. And I think part of that is because the clustering of people, skills and ideas in an approximate space with firms and finance and transport has worked really well. So we do need policies to support that success.

So in London, the policies that have helped is there's an integrated transport system that is working really quite well. I mean, not everyone might think this when they go on the London tube but actually, by comparison, it works really rather well. For instance, compared to Manchester, we've got three different transport systems, it's more expensive and takes longer to get across the metropolitan part of Manchester than it does to get across London. And that's even before you throw Crossrail into the equation. So that has worked well. A high concentration of universities and the sort of R&D communities that we've already mentioned. A rich financial system made up of banks, private equity, venture capital, but crucially, all of this in close proximity to the leaders of power in Westminster and Whitehall.

And that is also part of the success story, that those places have been able to lobby much more successfully for their needs and interests than more remote parts of the country. So if we want to maintain the success of London and the metropolitan part of the South East, those policies have to continue. What that means specifically is we need to continue to invest in R&D but also address the problems just mentioned, so the diffusion and how we can then grow businesses and not just have them bought up by foreign investors. We have to do that also to help unlock more business investment in the UK, which is very low and lower than in other countries. We have to keep on boosting trade, we have to...and of course mostly with our closest neighbours in the European Union, we have to help with housing, and we have to keep on upgrading the transport infrastructure.



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But I think the other question that arises here, besides what policies are needed to maintain the success, is, what does agglomeration not do? So, for instance, are there enough spill over effects from the successful areas to the adjacent areas? Is that really happening? Are London and the South East helping to pull up other areas or not? Or are the successes in places like Leeds or Nottingham or Manchester, Birmingham, Cardiff, Edinburgh, Belfast, and so on, are they actually helping to pull up other parts or not? And I think there is a question there and I'm not sure that those other adjacent areas are being sufficiently pulled up by the successful ones. I'm sure we'll come onto that later.

BVA: Yeah. So the feel that I get from all three of you is that, yeah, it's tough to actually...we have more policies in place that help the top to do even better. And that's why we tend to focus a lot more on how can we pull the rest along? Which is very important. But let me try one more thing that I believe is important here, and that is global talent. I mean, of course many of the places where we have strong productivity places, we see there is a lot of talent from the UK that has come to that place, but also globally that has come to that place. Are we comfortable that we...you know, with our university policies, with our science policies, we are in a sufficiently good position to continue to compete for global talents? Catherine, let me start with you.

CM: I think this is a challenge. The engagement with the global economy comes both as exporter and as importer of both ideas, people, products, money, and this is an area where there's been a retrenchment, there's been a retreat. And I think that that is something that's starting a little bit in a hole and more needs to be done in order to dig out of that hole and really reaffirm that the UK is part of the global economy, both on coming in and going out.

BVA: Diane?

DC: Well, I think this has been a really unfortunate area of policy, actually, and the government's desire to clamp down on inward migration has actually been in a sector, we've cut EU migration, inward migration, that migration from other countries has actually offset that. So the policy as a whole hasn't worked and actually I think it's got very damaging effects on high-skilled people. The number that you see wanting to leave universities to return to other EU countries. The perception, whether it's true or not, that it's incredibly difficult and costly to take up high skilled jobs in the UK if you're based overseas has had a really adverse effect on the productivity potential of the high performance that you're talking about.

BVA: Adrian, any policy that you would want to recommend to the next prime minister and the next education secretary to really face this issue?

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AP: Well, I think one is to make student visas for EU students a lot easier. I think there's still some complications that are wholly unnecessary. I think the next point is to say we absolutely should be part of Horizon 2020 and its successor project, because it's not just an incredible budget but also an extraordinary community of kindred spirits, of outstanding researchers across the European continent. And whilst Britain has, for sure, left the EU and is not about to re-join, it's very important to be part of that wider European research community.

And I think another policy will be to focus very clearly on housing. Housing is a massive issue, both the costs and the quality of housing in the UK, even in the places that are affluent, I think do mean that a number of people are being priced out. Because some of the younger talent, who would move over, including those with families, would really struggle to find enough liveable space in the right location. And if you then say, well, okay, but why don't you move out and have a long commute? Well, we know how unproductive that is and how, again, the transport infrastructure outside of London doesn't really lend itself so well to long commutes that will be productive.

I mean, long commutes will mean that people can listen to this podcast, that's great, but that raises productivity enough, I'm not sure. So I think we need to address housing as a matter of priority.

BVA: I'm really glad you mentioned the housing part because it's quite often discussed as part of the levelling up and the regions that need to improve, but it is also very much an issue for the leading regions, and particularly linked to this global talent issue that it's really important.

So let's look at the other side, of the other end of the pyramid, the large and broad-based bottom of that pyramid. Of course now all the narrative of the long tail of less productive firms that are scattered really across industries and regions, it's very wide spread. It's obviously critical to find ways to increase the dynamism at the bottom end and allowing companies to restructure, to access new markets, to adopt new technologies, so that they create more value, to grow to catchup with the leaders that we've just talked about.

Catherine, again, you've done a lot of research on this at the international comparative perspective, this is not unique to the UK, we see these issues everywhere. But there is concern in the UK that the pace by which the bottom is benefitting from the top and the way the diffusion policies are working isn't just working as well as it is in other countries, which also have their issues. But where do you think the main pain points are in that diffusion process in the UK that should be addressed?

CM: Right, so let's look at what the research for the OECD says with regard to the characteristics of this large bottom of the pyramid. The UK productivity



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identifies structural and sectorial differences in productivity performance relative to the peers, the OECD peers. So half of the lower relative productivity performance of the UK comes from non-financial services. A quarter comes from the financial services sector, and a quarter from manufacturing, other production and construction. So we can start to look at each one of those groups and talk about issues that are relevant in each sector. So kind of what's going on in those sectors with this very large tail.

There are size and regional factors and we've already heard a little bit about the regional issues where digital and transport linkages are really key factors. And I absolutely agree with the comments that Adrian has made about housing, it's a central problem, labour mobility being a central issue when it comes to increasing productivity. But on the size side, this very large tail tends to be small firms and very small firms, populated by workers with either lower skills or mismatched skills, lower capital intensity, and particularly of digital capital. So what could we do to think about improving the bottom of the pyramid?

I'm going to talk about internal challenges and external challenges on the internal side. Reallocation is sluggish, reallocation is hard, because it involves exit by insolvency or corporate restructuring, and that type of reallocation is what we mean by productivity growth, but it is challenging. Without reallocation, people, investment and financial resources are tied to the wrong firm or the wrong location. Workers aren't getting paid what they should be paid based on their skill characteristics. And this is where the low productivity comes from. While reallocation can be problematic, particularly if we're in an environment advising on performance, that's not the situation that we're in right now. And therefore, in some sense, reallocation should be more our go-to strategy now than perhaps earlier times during COVID, for example.

Digital investment, okay, it ultimately leads higher productivity outcomes, but it can be expensive upfront, particularly for smaller firms. Even with an investment tax credit, you still have to weigh out the money today before you're going to see the fruits of it coming later. But it's not just about the money, it's also about management and workers, because you have to reorient your processes, you have to reorient how your workplace is structured. And that type of changing of the mindset, both at the top and within the firm, can sometimes be hard. So digital by itself doesn't enhance in productivity, it's how it's used.

And so, you know, we don't want a computer like a potted plant in the corner, we want it to actually be integrated into the overall firm, and that can be hard for small firms. They may not know how to do it, they may not want to do it, because it changes the way the business works. We know that the firms that had app-based procedures and processes were more productive during COVID. So they had it in place, they were more productive.

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And then the last point that I think is important to think about is how workers and firms engage with each other's matters. This is, if we look at the training gap between fulltime and part-time workers in the UK, that gap is the largest in the OECD. So firms that really engage with their workers on a fulltime basis are committed and they engage with training. And workers that are not fully employed or partially employed really are getting a very short end of the training stick. And of course that is a very important ingredient as well, to both accepting digital or using digital, and taking advantage of opportunities.

So those are three areas that I think are important on the internal side. But of course we have to talk about the external again. More small firms have been disproportionately impacted by TCA. If you look at the detailed data, there's a 30 per cent drop in exports to the EU, small exporters to small EU markets, probably because of paperwork. And there's confirmation of that when we look at business surveys. So all of these companies are missing out on the productivity gains that come through global engagement.

**BVA:** This relocation issue has been probably an issue in the UK because we have had low wage growth for quite a long time, with the regional persistence, we actually had lack of mobility. So there might be very good reason to believe that the UK actually had weak reallocation happening. Would you say that rising costs and increasing wage and everything will...and the recession, as you say, it will take care of the reallocation? I mean, it will happen in this kind of environment, or if there's something policy-wise that can help smooth that reallocation effect a little bit to the benefit of productivity.

**CM:** Well, we can look back to the post-GFC period and the research done at the OECD on what you don't want to do. And actually this shows up as well in some of the COVID policies. We want to enhance worker mobility. It's difficult in an environment where policymakers are very concerned about unemployment. There's a tendency to rigidify markets and rigidify worker placement in an environment where unemployment is rising. It's exactly the time where you do need to take advantage of the, as you've put it, the cleansing effect of competition and change. So this implies that there has to be complementary policies to encourage mobility as opposed to stasis and employment situations to be part of the reallocation process so it moves forward as opposed to having a rigid approaches to the labour market.

**BVA:** Adrian, let's look again at this regional component at the bottom of the pyramid. We talked about the top end, but as you've already mentioned, it is at that weaker end that we have just many large reasons. We're not only...you know, we see they're not moving very fast, just a strong persistence of regional inequalities that seem, in some cases, even to be increasing.

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So to what extent should something change here rapidly in terms of policy making around regional development to really get these regions and places that are not doing very well? It's not just large regions but sometimes relatively small places adjacent to strong places, as you mentioned earlier. What are the policies that we should really put in place urgently to get them going?

AP: I think two things have to be tackled. One is the fact that the south, London and those metropolitan pads around it, are not just far ahead but getting further ahead, pulling strongly ahead. And we're going to see something like productivity levels more than 50 per cent above the national average compared with 40 20 years ago. So we're not levelling up at the moment, we are essentially deepening the disparities, so that has to be a real area of focus. And I think combined with that economic performance is the governance issue, that we have a governance and institution system in the UK that is one of the most centralised in all of the 38 OECD countries.

So two things are needed. We need to, in some sense, deconcentrate the economy and decentralise polity. And yes, devolution to Scotland, Wales and Northern Ireland as well as the city regions has certainly made a difference. But it's still essentially led by the centre, it's still very much treasury-dominated deals. And what it's really done is shifted responsibilities to lower levels but without giving them the decision-making powers or the financial resources. And I think what we therefore need is to think how we can get more decision-making power and more financial resource devolved to lower levels. Why? Not because low levels always get it right, but because they do have, in the end, better knowledge of local needs and local interests. And that a properly constituted system of governance, in some sense a more federal one, would also lead to better division of labour where the centre actually does what it's supposed to do.

At the moment, the centre micromanages all sorts of things they shouldn't be doing but doesn't do the big things it should be doing. And vice versa, the local levels are supposed to bid for these crumbs in a town's fund but they can't really even get a handle on schools' policy, which in local mixed high education and further education colleges, they could make quite a big difference. So I think it's the whole system that is lopsided, that is poorly structured and needs radical reform.

I think what could be done quickly is to think how to give lower levels some more resource, whether that is more redistribution, or whether it is even a share of income tax or any form of tax raising power that will help local levels have more financial autonomy. Where it's not the treasury that dictates almost every single spending envelope that they have.

BVA: Diane, you've written a lot about inequality, regional inequality and other ways of thinking about inequality. You have also written about revamping industrial policy and it seems that a lot of the comments that we've been

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discussing so far at a nexus of the tool as these two things, strong, better policies to get to better diffusion of the effects of productivity growth. But also a new industrial policy framework to really help the entire system to move forward. So how are you reflecting on comments that Catherine and Adrian have been making so far, from those two perspectives?

DC: I do agree with the comments. So let me try to amplify it in a couple of ways. So just to emphasise the point Adrian is making about how little decision-making power there is locally, there is a recent central government consultation on whether everywhere in the country should have the same coloured recycling bins, which is just absurd. And when you come to a very important area like the skills policy, the idea that there's no way for local knowledge about exactly what kinds of skills businesses need to feed into the macro frameworks set in Whitehall, it's just completely absurd and doesn't happen anywhere else in the developed world.

And add on top of that the fact that the skills policy in general is just a bit of a basket case. It changes all the time. We're asking individuals to make life-long decisions about their earning potential and what courses they're going to take, what subjects, where do they want to go to university? And the government changes education policy every other week practically. It's just a really bad framework.

So an easy thing to do that doesn't cost any money is that we know the apprenticeships programme isn't working well, companies are not taking up all the apprenticeships they should. Change the design of the programme and make sure that it works effectively, and let's start to chip away at this absolutely hopeless skills policy, and that will involve some devolution decision-making power to take advantage of local information.

The other thing I would say is that the notorious comment about people not working hard enough in this country really made me angry. There's a fantastic paper from, I think, the 1980s by the late Mancur Olson called Big Bills Left on the Sidewalk. And he makes this point that somebody who migrates from a poor country, like Haiti to the United States, immediately their productivity is increased many times over. And it's not because they're working harder or less hard or anything about them as an individual, it's because they've got better capital to work with. And so the idea that British workers are lazy and don't work as hard as others is just absurd when the problem is one about what levels of investment have there been?

Now to the bottom of the end of the pyramid that you're talking about, that's harder, they don't have enough money, they don't have the management capacity and retention. But I think there's now growing evidence that there are ways to pass on that kind of management know-how, how do you change your processes? How do you use the digital tools that Catherine is talking about? So let's think about those kinds of schemes. They don't need to be costly, they certainly don't need to involve them being expensive

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providers from outside the work tool, there's lots of provision potential already.

A really good example in the domain of schools was called the London Challenge, where headteachers from schools that weren't doing so well got sent to just look at what headteachers did in schools that were doing well. And there was money as well, but actually it's simply learning how to do things differently. There's a very powerful effect on pupil outcomes in schools across London. That same principle would apply to small businesses in the non-financial service sector that Catherine was talking about.

BVA: Some recurring themes in the discussion so far, obviously skills, innovation and digital improvements, the housing story, the need for reallocation, the regional policy. It still feels like there is a lot that needs to get done. So what I want to do after the break is to actually try to focus a little more and basically say, well, let's be the adviser to the Prime Minister and say, start with this. And of course we know there's a long term and a short term element to this so we'll look at both. But before we do that, we'll take a short break to hear about what else is happening at the Productivity Institute. [Break].

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*The Productivity Institute have released a report on making public sector productivity practical, in conjunction with Capita. In the report, Professor Bart van Ark connects the different perspectives from which we can approach productivity in the public sector, including concepts, measurement strategies and key levers to improve productivity to generate better outcomes for the public. The publication offers evidence-based advice on the steps that public sector organisations should take to improve productivity and to motivate and empower managers and employees.*

*For the report, visit the link to [capita.com](http://capita.com) in the show notes for this episode. For more information on our research and collaborations, visit [productivity.ac.uk](http://productivity.ac.uk)*

BVA: Welcome back to my discussion with Catherine Mann, Diane Coyle and Adrian Pabst on the policy agenda on productivity for the next government in the United Kingdom.

Now before the break, we spoke about the top and the bottom of the pyramid and the policy agenda for productivity that clearly needs to address both sides of this. Another cut for policymakers is to look at the long-term versus the short term effects. I mean, obviously the broad-based



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productivity recoveries don't happen overnight and that makes it perhaps hard for policymakers to focus. And it gets especially complicated because many aspects of the policy agenda are not so much economic policy but much more about the institutions and governance and, frankly, politics, especially between Westminster and Whitehall on the other hand, and other layers of government across the country.

So, Adrian, let's start with that element, because you mentioned it earlier, this centralised nature, the UK being the most centralised nation probably around the OECD economies. At the same time we do have this levelling up agenda which the previous government started. So you wonder to what extent are we on a path to actually really start to change this? Do you think we are...we have the right policies and vision? And again, what is it where you think governments should pick up as soon as possible to keep that focus on regional development and evolution going?

**BVA:** So I think the levelling up White Paper and the recently introduced sort of legislation are important because, at the very least, they recognise the depth of the problem, the sheer scale of the challenge. And the analysis is, I think, largely accurate about some of the causes, that less is there. I think there is broadly coherent framework, and also some measurable metrics. So there are certain things you can do with that approach.

I think what's lacking is funding and the institutional reforms to support all those efforts. I mean, you take one example, one of the missions by 2030 is to have internationally a globally leading city in each region of the United Kingdom. Well, with the best will in the world, that seems totally unachievable, and therefore the question is, why should we even have this as a target? Wouldn't it be better to say, let's raise the second tier of the UK cities to international levels, and then see whether we can do better? But I mean, that would be a more sensible thing to try and do, much more realistic, than to sort of talk about global leading cities everywhere up and down the country.

Another one is to do with health and housing and so on. And individually, they're all really good objectives, but you wonder where the financial and institutional support is to achieve them. So skills is a good example and Diane's already touched on it. I mean, in the spending review we had in October of last year, so some ten months ago or so, we were told that we were going to have a skills revolution based on three billion spending over three years. Now what that actually does is barely takes us back to 2010 spending levels. That's not a revolution, that's a drop in the ocean. It's never going to do anything to close the skills gap that we have in the UK, and the skills gap in the UK is two-fold.

It's about stem graduates, which we don't have enough, so science, technology, engineering and maths. But then also all the vocational and technical training that we lack, that was brutally exposed by COVID. So



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many of the key workers who helped us get through the pandemic are the ones who lack skills, and also lack pay and lack all of the support in order to do their jobs properly. The carers, the nurses, and so many others besides, not to talk of plumbers, electricians and so on, that we've also lacked chronically for so long.

So what we really need is a comprehensive strategy that addresses the skills gap and that looks at the top end, the stem graduates, but also the technical vocational skills, and does so by enabling local authorities, and indeed regions, to make those decisions, where needs and interest are much clearer than they are seen from Whitehall and Westminster. So I think that has to be an area of priority.

**BVA:** But given the obvious limitations that we're going to face on funding here, let's stay to the policy agenda...for the skills agenda for a moment. Should we perhaps prioritise and say, look, you can't do everything because that will be just a massive spend and at least in the short term it's not going to be possible. What we want to focus on, for example, FE colleges first, or particular regions in the country first in order to make sure that we set some good examples of what might work that others can learn from. So is there any way that we can use the limited amount of funding that we have available more effectively than we have done in the past?

**AP:** Yeah, I think that's a really good point and one specific example is to say, okay, the people and the places that need it most are those very deprived peripheral places. Places like Grimsby, Southend, Blackpool and others, where you have mixed AG FE colleges. So rather than say, we'll let's build a university in those places, or we'll just focus on vocational and technical skills, focus on the hybrid institutions that can help you do that and that already exist. But again, where there isn't the decision-making power or the resource.

So I think if you support those sorts of mixed colleges with a real injection of cash and some great autonomy as to how they deliver their programmes, I think you could help close the skills gap in some of those regions. That will also mean people can stay there. And if you have job creation, I know it's a big if, but then you might also be able to offer those people who've gone to the colleges a job that's more local and they don't necessarily have to look to Manchester or Leeds or London for their next job.

**CM:** The one word that wasn't included in that is businesses know what they want, and there's often a sort of a reluctance to tie workers too closely to businesses with a bespoke training programme because there are concerns about that. But I think in this environment where we can't just produce training programmes without knowing what it is that businesses want. So they have to be part of the equation in allowing small businesses worry that if I train, my worker will get poached. So there is a role, an externality, where businesses tell institutions, these are the kind of skills we

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need, and then the institutions take on the job so as to avoid the poaching problem.

**BVA:** Yeah, I think that's a really important point and at the Productivity Institute, we do work on actually looking at to what extent we can involve FE colleges much more directly with business. And one thing that we do actually find is that businesses find it sometimes hard, particularly smaller businesses, to articulate their skill needs. But that in collaboration with FE colleges, they would actually be much more able to do some foresighting, to really start to build some capacity. These things take time, but at the moment the programmes that we find the Government is actually doing is just too small, too short durations, and you need really to have a sort of consistent commitment with the theme that comes back over and over again.

Diane, I want to come back to another issue referring to your piece in the Financial Times that I mentioned earlier and that is available for the show notes, and that is the roles of the public sector. The public sector has two roles, of course this is a role to provide the right condition for the private sector to be productive, but public sector productivity itself is also quite important. And one of our previous podcasts, actually the previous one, number 19, is on this topic. But again I think it's something that we hear the candidates for prime ministership talking about, we need more efficiencies in government.

And what I worry about is that that means budget cuts and it looks like we are achieving. At least that's the research that we have done so far, that in quite a few sectors, healthcare notably, were sort of achieving the limits of booking any kind of effective productivity improvements without seriously affecting the quality of the service, if we would just do it for budget cuts. So what is it that we should do in government itself to strengthen productivity?

**DC:** Well, Bart, I think you know more about this than I do, but let me have a go. I mean, obviously cutting the budget might deliver some improvement in the numbers short-term, but it's very counterproductive long-term. Because effective public services are the bedrock of a productive economy and they affect human capital. They help private companies improve their own productivity, and so on. And it may be the case that improving productivity in public services will eventually improve their quality and quantity of output and reduce costs in the longer term. But the investment in digitalisation and processes has to be there to enable that to happen. But it is really important.

And again, it doesn't all have to be costly. There's a very nice example, Adrian referred earlier to how difficult it is to cross the whole of Manchester, or indeed the whole of the north of England, compared to getting across London. The Mayor of Greater Manchester, Andy Burnham, has just successfully taken back the powers to franchise the bus system and create a region-wide transport network where it's easy to pay and it will help people get to work much faster and get to wherever they want to be much faster.

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And so that's a kind of devolved power that will improve the public services and private services of transport and it will help businesses in Greater Manchester.

I do think public service productivity is important. We have clearly underfunded both education and health since 2010. Adrian was just referring to that period of austerity and that has undercut our ability to have a productive private sector, so we've got to fix that and that will cost money. But as you were hinting, if we achieve some public service reforms and innovations, then that will in the longer term help save money or deliver better outcomes, or both.

**BVA:** Catherine, a big complaint, and it's the truth for all the podcasts we did but it's also very clearly in this podcast, is this sort of lack of stability and commitment for the longer term. And again I want to have you reflect a little bit on your international experience here, because are there other countries...? I mean, there's this tendency to think of Germany, or that Asian economies tend to have more of a longer term focus. And what is it that makes them successful to do that? What is it that we can advise this government to say, stay on to something that actually works or make a commitment that can really get us on a road for a couple of years, rather than get into this kind of churning thing that's been mentioned before?

**CM:** It's been already mentioned the extent to which business investment in the UK has been very slack for an extended period of time, capital investment much lower than its peers. And there are a number of reasons for that, but part of it is, as you say, uncertainty is negative for business investment and uncertainties of very many different kinds. And yes, there have been many shocks that certainly affect the business environment. But policies should not accentuate the uncertainties that are coming down the line in the context of the shocks. So that issue goes, maybe it's not always exactly in the direction where you want to go, but there's something to be said for steady as you go, creating an environment which is more supportive of business investment.

**BVA:** Let me ask all three of you, and I'll start with you, Diane, because you were on it, should we have a new industrial strategy committee? Should we revamp, should we revive it? Or if not, what should we have to make sure that industrial policy gets better coordinated? Because at the moment we frankly have nothing.

**DC:** We don't have any institutions that enable the strategic view of what the economy needs that Catherine was just talking about. And it's a great contrast to the East Asian economies where they have built institutions that aren't partisan and where it's possible to learn what works and what doesn't work and change things without looking like you're doing a policy U-turn. It's just learning and adaptability built into a consistent long-term framework.

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So this speaks to both Catherine's point but also Adrian's point about the institutions that we have here that don't enable that.

So that could be a new industrial strategy council. It could even be that government itself evaluates its own policies much more than happens. The National Audit Office has pointed out how little evaluation goes on in government of whether policies are working or not. We don't know whether the money is being well spent, if tax payers are getting value for money, if there are no government departments as they go along looking at whether a policy is working, and if not, changing it. So it's a combination of having a stable framework and evaluation but being able to learn what's going on within that.

**BVA:** Adrian, do we need an industrial strategy council back or do you have another suggestion?

**AP:** I agree entirely with both Diane and Catherine's remarks about how the role of policy is to reduce uncertainty, to provide greater predictability and help a country in all its diversity to absorb the shocks that it faces. And I think the institutional framework has to be designed in such a way as to make that more the case than it currently is. So, yes, an industrial strategy council I think would be helpful, but it has to be cross-departmental. It can't just be that a single department does industrial policy because I think it relates to so many aspects of government. And the same is true for levelling up. Levelling up is something that has to, in the end, be embedded in all departments, it can't just be done from one department.

The other institutional reform that has been talked about and I think should be seriously considered is whether treasury doesn't do too much and thereby doesn't do other things that it should be doing. So maybe you should be looking at a radical reform, have a ministry of finance, have a ministry of the economy and industrial policy. A much stronger department than BEIS currently is, where industrial strategy has completely dropped out. And then also have maybe something like a budget office that actually looks at spending and also can do much more of what Diane just said, which is look at how well money is spent.

And it's interesting, when the OBR talks about deficit and debt and spending, some politicians say that they're not interested in normative judgements. Well, is that really going to improve policy, to say, we don't want any normative judgements, we just want the numbers from the OBR? I don't think so. So we have to embed in government many more checks and balances so that investment decisions and spending decisions can be made with much better knowledge. At the moment, the centre, because it does too much and micromanages, actually doesn't really know what's going on elsewhere. It doesn't understand the needs, and therefore fails to act on the big challenges, whether it's skills, or infrastructure and investment outside of London, housing and so on.

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And I think this is the tragedy, that even with quite colossal amounts of money we're occasionally spending on health and education, can we really talk about first rate and world class public services? I'm afraid I don't think so. We need them but I don't think we have them.

BVA: Catherine.

CM: The one aspect of an industrial policy committee or group within government that causes me a little bit of a concern is two-fold. One is it's very important to not have the government mandate but it is that it's going to be the next thing for a country to do. And this is something that Asian economies do do. There's a real direction and choice of sectors. We hear about the successes, we don't hear so much about when those choices have not been successful, so it's a very biased sample.

And so what I'm calling for essentially is a much richer relationship between any government approach or government assessment and the businesses that are going to be the ones who are going to have to carry out the policies to get the benefit of the policies. That's one aspect.

The second aspect of course is that we have emphasised, and Adrian in particular has emphasised the importance of devolution. And so having a central-based industrial policy strategy is exactly the opposite of this approach towards devolution, towards the regions to have more say in how to approach and enhance productivity or enhance skills or education or whatever. So there is this tension between centralisation and top-down versus devolved and bottom-up. And I think that that is something that ought to be kept in mind when considering moving forward with something that has more guidance from the top.

DC: I completely agree, Catherine, that's a great point. But on your first concern, I would say the answer to that is really strong competition policy and an independent competition authority. Because the mistake made in the past was linking industrial strategy to particular companies being the beneficiaries.

CM: Right, but if we think about the success stories in Asia, a lot of that is about not having competition, competing externally. The strategy here has to be competing externally but also competing internally as a critical aspect of the policies.

BVA: Yeah, and I think your second point on the regional complement to any kind of industrial strategy is really important and probably something that, if you think about levelling up, has to be very important. One of our TPI members, Philip McCann, has recently written a paper basically arguing that if we do productivity at the central level, we have to do it institutionally also at a

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regional level to complement these activities and to make sure that that sort of relationship between regions and government is very clear.

Now we're running out of time but I just want to ask one final question to each of you. And that is, that if I would be in No 10, which thank god I won't be, but if I would be and you would come in, I would say, well, this all sounds great and well and I really think productivity is important. But I've got a recession coming up, I have a cost of living crisis, I have a massive pressure on government. But yet tell me what I should do now to perhaps make productivity part of the equation to get out of this mess. Or at least avoid not to go further down in a hole of productivity slowdown that we're already in.

So what is it? Given all these pressures short-term that you want me to do now. So I'm putting you on the spot here, but this was not in the guiding notes for the podcast. So Catherine, I'm going to start with you, if you don't mind.

CM: So I'm going to put my Bank of England hat on, which is an independent central bank, but we do play an important role in this overall puzzle of improving productivity. And what I'd have to say is, very high inflation, which of course we are experiencing right now, has many downside consequences. But in the context of our questions here on productivity, a particular concern is that in a high inflation environment, firms are scrambling to figure out what their best pricing strategy is.

Productivity, on the other hand, comes when firms focus their attention on their products, their people, their investment choices, and their global and domestic market opportunities. Not when they're trying to figure out menus and how their prices need to be changing. So from my standpoint, my job is to bring inflation back to two per cent target and it's something that the bank is committed to doing. And I believe that this will be part of creating the environment where firm decisions support productivity growth.

BVA: Adrian.

AP: So I started by talking about housing and I think one policy for the next prime minister and government should be a much more ambitious number of newbuilds, including socially affordable housing. Also, ecologically, much more sustainable with proper insulation, and thereby lower energy needs. And I think the government should commit to building up to 300,000 new homes every year. And basically do this by talking to the businesses that can deliver this, so big construction companies. On the brownfield land where building permission has already been granted, and say to them, build, use it or lose it. Use the land, on which there's planning permission to build, or, ultimately, after a period of a year or two, lose that land so other people can come in and build. So a very ambitious housebuilding programme, especially for the areas where there's a chronic shortage.



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BVA: Very clear. Diane, your key policy advice with a government that is really struggling to get their arms around the problems?

DC: Stop tweeting, devolve powers, and you're going to have to spend the money on the NHS, so do it with a strategic view to shaping a healthy population because without that we don't have an effective economy.

BVA: Well, that's clear advice and we do hope that whoever gets into Downing Street, we probably will know, many of you listeners will know by the time that you're going to listen to this webcast, but I hope they will get some of the news one way or another from this great discussion. Thank you, Catherine Mann, Diane Coye and Adrian Pabst for this last episode on a really important topic, policy priorities for productivity in the new government.

Thank you very much.

This then concludes our first season of Productivity Puzzles. You can listen back to our 20 episodes of the past year on [productivity.ac.uk](http://productivity.ac.uk) or on your favourite podcast platform. As there has been enough left to discuss and to action on, there will be a new season of Productivity Puzzles which will turn into a monthly series starting in September. We promise you another podcast on regional productivity issues, which obviously is so critical to the story, and we'll start doing some interesting research at the Productivity Institute on intermediary skills, which we would like to share with you. And there will be much more. So stay tuned.

You can sign up for the entire Productivity Puzzles series through your favourite platform to make sure you also don't miss out on any future episodes. If you would like to find out more about the work by the Productivity Institute, please visit our website at [productivity.ac.uk](http://productivity.ac.uk) or follow us on Twitter and LinkedIn. Productivity Puzzles was brought to you by the Productivity Institute and it's sponsored by Capita. And this was me again, Bart van Ark at the Productivity Institute. Thanks for listening and stay productive.

**End of transcript**